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Business Outlook Survey

Conducted by the Bank's Regional Offices

Results of the Spring 2010 Survey

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Overview

- Responses to the spring survey provide further evidence that the recovery is taking hold.
- On balance, firms expect sales growth to pick up over the next 12 months, and plan to increase investment spending and employment. Their investment plans are increasingly being targeted at expansion and at improving efficiency to promote future growth.
- While capacity pressures remain subdued, the balance of opinion on output prices is at a new high. Firms cited intentions to keep prices stable or to raise them slightly, following a period of price discounting during the recession. As well, in line with improving demand, firms cited plans to at least partially pass on higher costs of inputs. Inflation expectations moved up but are well anchored within the Bank's inflation-control range.
- Following an improvement in credit conditions in the winter survey, firms in the spring survey, on balance, reported that credit conditions were essentially unchanged over the past three months.

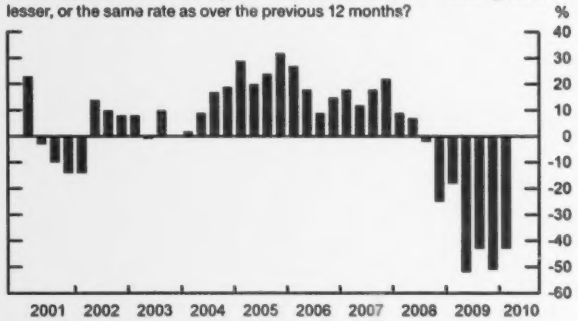
Business Activity

The balance of opinion on past sales growth remains near its record low **(Chart 1)** and continues to reflect the effects of the recession on sales activity over the past year. The balance of opinion on future sales growth edged down but remains at a high level, indicating that firms expect sales to grow at a faster pace over the next 12 months **(Chart 2)**. In many cases, firms expect a modest increase in sales

Chart 1: While firms report a slowing in sales growth over the past 12 months . . .

Balance of opinion*

Over the past 12 months, did your firm's sales volume increase at a greater, lesser, or the same rate as over the previous 12 months?



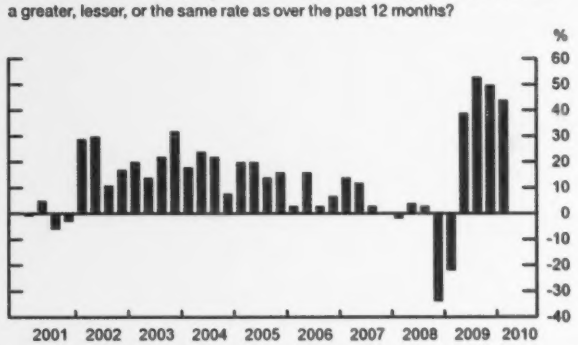
Greater: 22% Same: 13% Lesser: 65%

* Percentage of firms reporting faster growth minus percentage reporting slower growth

Chart 2: . . . they expect sales growth to pick up over the next 12 months

Balance of opinion*

Over the next 12 months, is your firm's sales volume expected to increase at a greater, lesser, or the same rate as over the past 12 months?



Greater: 64% Same: 16% Lesser: 20%

* Percentage of firms expecting faster growth minus percentage expecting slower growth

The Business Outlook Survey summarizes interviews conducted by the Bank's regional offices with the senior management of about 100 firms selected in accordance with the composition of Canada's gross domestic product. The survey's purpose is to gather the perspectives of these businesses on topics of interest to the Bank of Canada (such as demand and capacity pressures) and their forward-looking views on economic activity. Additional information on the survey and its content is available on the Bank of Canada's website at <www.bankofcanada.ca/en/bos/index.html>. The spring 2010 survey was conducted from 22 February to 18 March 2010. The balance of opinion can vary between +100 and -100. Percentages may not add to 100 because of rounding.

The opinions expressed are those of the respondents and do not necessarily reflect the views or policies of the Bank of Canada. The method of sample selection ensures a good cross-section of opinion. Nevertheless, the statistical reliability of the survey is limited, given the small sample size.

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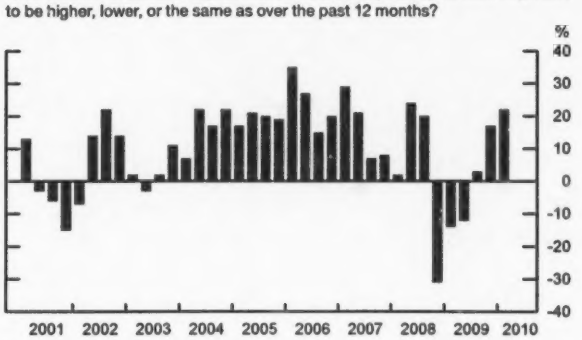
volumes following declines over the past year. Firms reported that sales expectations are supported by the general economic recovery, an improving near-term U.S. economic outlook, and, in a growing number of cases, their own initiatives to reposition themselves for growth.

The balance of opinion on investment in machinery and equipment moved further into positive territory, pointing to an increase in investment spending over the next 12 months **(Chart 3)**. Rather than just repairing or replacing existing equipment, firms are increasingly focusing investment spending on expansion—often into new markets or product lines—or on improving efficiency. This is particularly the case among manufacturers.

Chart 3: Firms expect to increase investment in machinery and equipment

Balance of opinion*

Over the next 12 months, is your firm's investment spending on M&E expected to be higher, lower, or the same as over the past 12 months?



Higher: 43% Same: 36% Lower: 21%

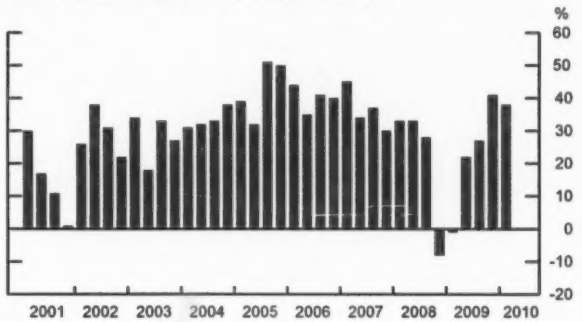
* Percentage of firms expecting greater investment minus the percentage expecting less investment

The balance of opinion on employment remains at a high level **(Chart 4)**, reflecting firms' intentions to expand their workforces over the next 12 months, in line with anticipated improvements in demand and plans for new projects, locations, or products.

Chart 4: Firms expect to increase employment

Balance of opinion*

Over the next 12 months, is your firm's level of employment expected to be higher, lower, or the same as over the past 12 months?



Higher: 50% Same: 38% Lower: 12%

* Percentage of firms expecting higher levels of employment minus the percentage expecting lower levels

Pressures on Production Capacity

The percentage of firms indicating that they would have difficulty meeting an unexpected increase in demand is essentially unchanged from its level in the winter survey and continues to indicate subdued capacity pressures **(Chart 5)**. Most firms are operating below capacity and expect this situation to persist for at least the next six months, consistent with the view that demand will recover at a gradual pace.

Chart 5: Capacity pressures remain low

How would you rate the current ability of your firm to meet an unexpected increase in demand?

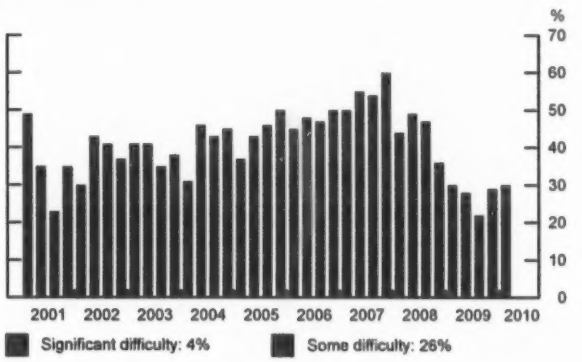
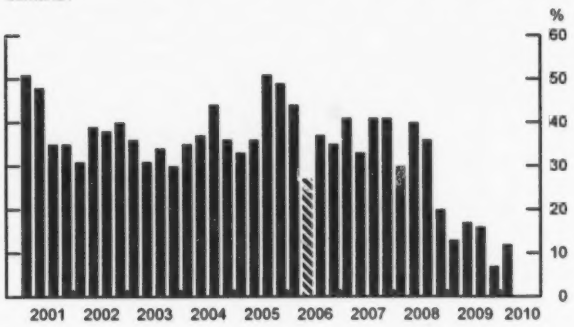


Chart 6: Few firms report labour shortages

Does your firm face any shortages of labour that restrict your ability to meet demand?



Yes: 12%

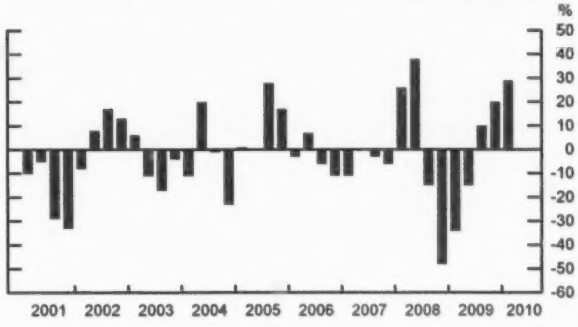
The summer 2006 results are not strictly comparable with those of the other surveys, owing to a difference in the interview process for that survey.

The number of firms reporting labour shortages that restrict their ability to meet demand has edged up slightly, but remains very low, reflecting the increased availability of labour **(Chart 6)**.

Chart 7: Firms expect input prices to increase at a greater rate

Balance of opinion*

Over the next 12 months, are prices of products/services purchased expected to increase at a greater, lesser, or the same rate as over the past 12 months?



Greater: 46% Same: 36% Lesser: 17% No response: 1%

* Percentage of firms expecting greater price increases minus the percentage expecting lesser price increases

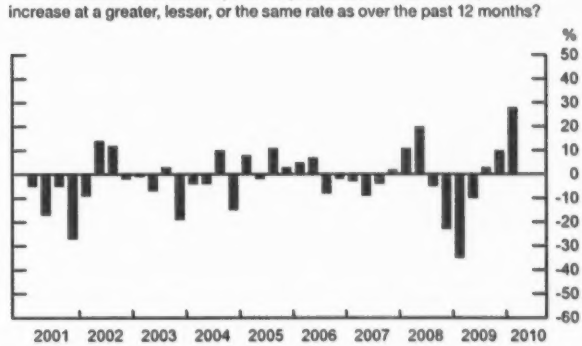
Prices and Inflation

The balance of opinion on input prices is positive **(Chart 7)**, indicating that firms expect the prices of inputs to increase at a greater rate over the next 12 months. Expectations regarding prices for commodities and related inputs are driving this result. Following price declines last year, firms expect the prices of these inputs to rise over the coming year as a result of stronger global demand.

Chart 8: Firms expect output prices to increase at a greater rate

Balance of opinion*

Over the next 12 months, are prices of products/services sold expected to increase at a greater, lesser, or the same rate as over the past 12 months?



Greater: 45% Same: 38% Lesser: 17%

* Percentage of firms expecting greater price increases minus the percentage expecting lesser price increases

The balance of opinion on output prices is also positive **(Chart 8)**, indicating that firms expect output prices to increase at a greater rate than over the past 12 months. The record-high level of the balance of opinion in the spring survey partly reflects firms' intentions to keep prices stable or to raise them slightly, following a period of price discounting during the recession. With demand improving, firms also cited intentions to pass along some of the expected increase in input costs as they focus on restoring or protecting profit margins.

Expectations regarding total CPI inflation over the next two years remain well anchored, with nearly all firms anticipating that inflation will be within the Bank's inflation-control range of 1 to 3 per cent **(Chart 9)**. However, more firms expect inflation to be between 2 and 3 per cent than in the winter survey.

Chart 9: Inflation expectations remain anchored within the Bank's inflation-control range

Over the next two years, what do you expect the annual rate of inflation to be, based on the consumer price index?

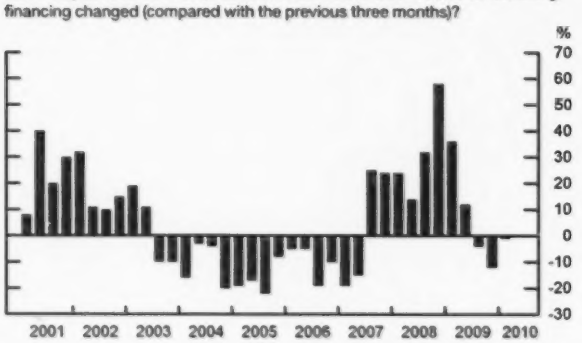
Credit Conditions

After indicating that credit conditions had eased in the three months leading up to the winter survey, the balance of opinion in the spring survey is just below zero **(Chart 10)**, suggesting little change in firms' access to credit over the past three months. In general, large firms continued to report an easing, citing general improvements in capital markets and improving terms and conditions from domestic banks. However, there were fewer reports of easing than in the winter survey, particularly among those firms that source their financing from capital markets. Small and medium-sized firms reported that credit conditions were either unchanged or had tightened over the past three months. Firms reporting tighter access to credit often attributed it to firm- or sector-specific factors. Overall, many firms noted that access to credit remains more restrictive than it was prior to the intensification of the financial crisis in September 2008.

Chart 10: Firms report little change in credit conditions over the past three months

Balance of opinion*

Over the past three months, how have the terms and conditions for obtaining financing changed (compared with the previous three months)?



Tightened: 14% Not changed: 71% Eased: 15%

* Percentage of firms reporting tightened minus percentage reporting eased. For this question, the balance of opinion excludes firms that responded "not applicable."

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